FISCAL NOTE

Bill #:	SB 475	**Title:**	Realty transfer tax over $75K on residences and ag. land -- income tax credit
Primary Sponsor:	Esp, J	**Status:**	As Introduced

Sponsor signature Date   Chuck Swysgood, Budget Director Date

Fiscal Summary

	FY 2004 Difference	FY 2005 Difference
Expenditures:		
General Fund	$220,803	$176,967
Revenue:		
General Fund	$3,220,586	$2,518,560
Net Impact on General Fund Balance:	$2,999,783	$2,341,593

☒ Significant Local Gov. Impact
☒ Technical Concerns
☐ Included in the Executive Budget
☐ Significant Long-Term Impacts
☐ Dedicated Revenue Form Attached
☐ Needs to be included in HB 2

Fiscal Analysis

ASSUMPTIONS:

1. Beginning on July 1, 2003, SB 475 provides for a 1% realty transfer tax on residential and agricultural real property. The first $75,000 of market value is exempt from the tax. The proposal allows an individual income tax and corporation license tax credit for realty transfer tax payments on the first $425,000 of taxable value.
2. For this analysis, it is assumed that the base for the realty transfer tax is composed of the transfer of residential land and improvements and agricultural land upon transfer of title.

Residential Class 4 Property

3. It is estimated that there are approximately 317,000 single-family residential dwellings in Montana. The estimated number of existing single-family home sales in 2001 was 22,600 (National Association of Realtors). Using the aforementioned assumptions, the anticipated turnover ratio for residential property is 7.1% (22,600 / 317,000). This ratio is applied to all values ranges in residential property.
4. For purposes of this fiscal note, fiscal 2004 reappraisal values for residential land and improvements are based on preliminary 2003 full reappraisal values. The fiscal 2005 residential land and improvements tax base is estimated by applying an annual growth rate of 4% to the preliminary 2003 full reappraisal value.
5. It is projected that in fiscal year 2004 approximately 195,000 residential land and improvement properties will have a full reappraisal value over $75,000, with a total estimated reappraisal value of $29,513,000,000. It is projected that in fiscal 2005, approximately 199,600 residential properties will have a reappraisal value over $75,000, with a total estimated reappraisal value of $30,942,300,000.

6. To find the tax base, $75,000 is subtracted from the real property value declared on the reality transfer certificate. In FY 2004 the total combined amount in excess of $75,000 on the estimated 195,000 residential land and improvement properties is approximately $14,625,000,000. In FY 2005 the total combined amount in excess of $75,000 for the estimated 199,500 residential land and improvement properties is approximately $15,987,000,000.
7. Assuming an anticipated turnover ratio of 7.1% for both years provides a tax base of $1,038,375,000 ($14,625,000,000 x 7.1%) in FY 2004, and $1,135,077,000 ($15,987,000,000 x 7.1%) in FY 2005.
8. A 1% realty transfer tax on residential land and improvements in excess of $75,000 will generate an estimated $10,383,750, and $11,350,770 in fiscal years 2004 and 2005, respectively.

Residential Income Tax Credit

9. Under the provisions of the bill, an income tax credit may be taken on the first $425,000 of taxable market value. This means that any tax collected on the value of property between $75,000 and $500,000 ($75,000 + $425,000), is eligible for the income tax credit provided for by the proposal. (See technical note 10)
10. For fiscal year 2004, it is estimated that 95.3%, or $9,895,714 ($10,383,750 x 95.3%) of realty transfer tax collections on residential real property will be eligible for the income tax credit. This means that $488,036 ($10,383,750 - $9,895,714) in realty transfer tax collections on residential real property will not be eligible for the income tax credit in FY 2004, and will remain in the general fund.
11. For fiscal year 2005, it is estimated that 94.7%, or $10,749,179 ($11,350,770 x 94.7%) of realty transfer tax collections on residential real property will be eligible for the income tax credit. This means that $601,591 ($11,350,770 - $10,749,179) in realty transfer tax collections on residential real property will not be eligible for the income tax credit in FY 2005, and will remain in the general fund.
12. Both residents and nonresidents are allowed the income tax credit, which can be carried over to following years, for up to 7 years. Residents and nonresidents will see different tax impacts due to SB475, because their Montana income tax liabilities differ significantly. Nonresidents typically will have lower Montana income tax liabilities than residents, which will limit their ability to use the income tax credit.
13. The Department of Revenue does not have statistics on *resident* versus *nonresident* property ownership. However, the department does have a mailing or billing address in the property database. The mailing or billing address does not denote whether an individual is a *reside*nt or *nonresident*, but rather is an indication of where the property tax bill is mailed. Although this is not a perfect indication of residency, it gives some insight into the relationship between residency and ownership, and is used for this analysis.
14. In tax year 2002, residential class 4 property with a Montana billing address made up approximately 90.5% of the total residential class 4 value in the state, while property with an out-of-state billing address made up the remaining 9.5%.
15. For this analysis, it is assumed that the proportion of realty transfer taxes paid by *Montana residents*, and *nonresidents* each year, is equal to the proportion of property with a Montana billing address (90.5%) versus those with an out-of-state a billing address (9.5%).
16. Using the abovementioned assumptions, *Montana residents,* from transfers of class 4 residential property, will have estimated realty transfer tax payments that are eligible for the income tax credit totaling $8,955,621 ($9,895,714 x 90.5%) in FY 2004, and $9,728,006 ($10,749,179 x 90.5%) in FY 2005.
17. It is estimated that *nonresidents,* from transfers of class 4 residential property, will have estimated realty transfer tax payments that are eligible for the income tax credit totaling $940,093 ($9,895,714 x 9.5%) in FY 2004, and $1,021,172 ($10,749,179 x 9.5%) in FY 2005.
18. Because not every taxpayer's income tax liability will be high enough for them to take the total amount of eligible credit, some amount of credit will be unrealized in the year in which the transfer tax is imposed.
19. For purposes of this fiscal note, it is estimated that 90% of the total eligible income tax credit for *Montana residents* will be taken in the year of the transfer, with the remaining 10% of the credit being carried forward into the next year. *Nonresidents,* because they typically will have small, or zero Montana tax

liability are projected to be able to use only 10% of the total amount of eligible income tax credit in the year of the transfer; while the remaining 90% will be carried forward, with 10% taken each year thereafter until the credit is expired after the 7th year.

20. Using the abovementioned assumption that *Montana residents* will be able to use 90% of their eligible income tax credit each year, it is projected that *Montana residents* will take income tax credits for realty transfer tax payments of $8,060,059 ($8,955,621 x 90%) in FY 2004, and $9,650,768 ($8,955,621 x 10% in carry over + $9,728,006 x 90%) in FY 2005.
21. The remaining realty transfer taxes paid by *Montana residents*, not taken as an income tax credit, of $895,562 ($8,955,621 - $8,060,059) in FY 2004, and $77,238 ($9,728,006 - $9,650,768) in FY 2005 remains in the general fund.
22. Using the assumption that *nonresident* taxpayers will be able to use 10% of their eligible income tax credit each year, it is projected that *nonresidents* will take income tax credits for realty transfer tax payments of $94,009 ($940,093 x 10%) in FY04, and $196,127 ($94,009 carry over + $1,021,172 x 10%) in FY05.
23. The realty transfer taxes paid by *nonresidents*, not taken as an income tax credit, of $846,084 ($940,093 - $94,009) in FY04, and $825,045 ($1,021,172 - $196,127) in FY05 remains in the general fund.

Class 3 Agricultural Land

24. Currently, there are approximately 50,400,000 acres classified as class 3 agricultural land in Montana.
25. Applying the 2002 average value per acre of $384 (Montana Agricultural Statistics) would provide a base value of $19,353,600,000. To find the estimated value of class 3 property for fiscal 2004 and fiscal 2005, an estimated inflation factor of 2.4% was applied to the 2002 base value of $19,353,600,000. The total estimated value of class 3 agricultural land is $19,818,086,400 ($19,353,600,000 x 1.024) in FY 2004, and $20,293,720,474 (19,818,086,400 x 1.024) in FY 2005.
26. Since the parties to the sale of agricultural land are not required to report the value of the property being transferred on a realty transfer certificate, DOR does not have statistics on the value of agricultural land being transferred. Dr. Watts at Montana State University, with the use of data from the 1999 economic and land ownership survey from the National Agricultural Statistics Service, estimated that agricultural land subject to the realty transfer tax is transferred at a rate of 0.5% per year.
27. Using the aforementioned assumptions, a 1% realty transfer tax on agricultural land is estimated to generate $990,904 ($19,818,086,400 x 0.5% x 1%) in fiscal 2004, and $1,014,686 ($20,293,720,474 x 0.5% x 1%) in FY 2005.
28. Because Montana income tax liability on agricultural land is generally minimal, or negative, it is expected that an income tax credit for payment of realty transfer taxes will benefit only a few agricultural land-owners. Revenue reductions due to the income tax credit for payment of realty transfer taxes is anticipated to be minimal.
29. For purposes of this fiscal note, the entire amount of realty transfer tax collected on agricultural transfers of $990,904 in FY 2004, and $1,014,686 in FY 2005 is considered additional general fund revenue.

General Fund Revenue Summary

30. The total amount of revenue generated from the 1% realty transfer tax on residential and agricultural real property in fiscal year 2004 is estimated to be $3,220,586 ($488,036 + $895,562 + $846,084 + $990,904), and $2,518,560 ($601,591 + $77,238 + $825,045 + $1,014,686) in fiscal year 2005.

Administrative Costs

31. The department estimates the 61,200 property reviews each year will be necessary to determine the validity of the value reported on the realty transfer certificate, or if the exemption under the bill is applicable.
32. Eeach sale review will require 10 minutes, equates to 612,000 minutes, or 10,200 (612,000 ÷60) hours.
33. Six additional FTE will be required under the proposal to review the 61,200 transfers (10,200 hours ÷ 1,760 work time hours per employee per year), at a cost of $153,372 in FY04, and $152,390 in FY05.

34. Equipment and operating expenses, which include contract services, supplies, rent, computer equipment, postage, and a one time exemption affidavit set up cost is estimated at $67,431 in FY04, and $24,577 in FY05.
35. Total estimated administrative costs are $220,803 ($153,372 + $67,431) in FY 2004, and $176,967 ($152,390 + $24,577) in FY 2005.
36. The department would bear other administrative costs relative to the extent of the department's role in the dispute resolution process. To ensure fair and equitable resolutions to realty transfer tax disputes the department would bear administrative costs to the extent of the number and complexity of the disputes (see technical note 7).

FISCAL IMPACT:	FY 2004 Difference	FY 2005 Difference
FTE	6.00	6.00
Expenditures:		
Personal Services	$153,372	$152,390
Operating Expenses	$32,631	$24,577
Equipment	$34,800	
TOTAL	$220,803	$176,967
Funding of Expenditures:		
General Fund (01)	$220,803	$176,967
Revenues:		
General Fund (01)	$3,220,586	$2,518,560
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):		
General Fund (01)	$2,999,783	$2,341,593

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:
1. The proposal assigns additional duties to the local government staff, specifically treasurers without any additional funding (see technical note 6 and 8). This could be in violation of 1-2-112, MCA, which requires additional finances to local governments if they are required to perform duties outside the normal scope.
2. New Section 2, Sub (4) states that if a value declared on the transfer certificate is unknown, then "the market value must be determined by an appraiser approved by the department". This suggests that the taxpayer will be responsible for the cost of appraisal on such property. Typical property appraisals cost $400 to $450.

TECHNICAL NOTES:
1. The proposal requires that the realty transfer tax be imposed on the value declared on the realty transfer certificate. The value listed on the certificate when agricultural land is transferred could include consideration for the transfer of property not subject to the tax: for example, business equipment is often included in the sale of agricultural land. The proposal does not provide a mechanism for allocating the sales price listed on the realty transfer certificate to the exempt and non-exempt property being transferred.
2. New Section 1, Sub (2)(b) includes growing timber in the description of "real property". It is not clear if, or how growing timber would be taxed under the new provisions of the bill. Growing timber is not in any

class of property and is not taxed under property taxation. In addition, currently, when timber is extracted, a realty transfer certificate is not required. Timber is subject to a $0.15 per thousand board feet severance tax under current law.

3. In New Section 1, Sub (4)(a)(i), the intent of the phrase “including the amount of any lien or liens on the real property” as declared on the certificate required in 15-7-305, MCA is unclear. There is nothing in 15-7-305 (Realty transfer certificate requirement) that addresses including the amount of liens on the property. The way its worded may require the DOR to conduct title searches to validate this information.
4. New Section 2, Sub (4) states that if a value declared on the transfer certificate is unknown then “the market value must be determined by an appraiser approved by the department”. This suggests that the taxpayer will be responsible for the cost of appraisal on such property. Typical property appraisals cost $400 to $450.
5. New Section 2, Sub (5) states that if property subject to the tax is located in more than one county, the treasurer will collect the total amount of tax due and forward it to the department, etc. Property cannot be transferred without filing a deed in each county along with a corresponding RTC in each county, so this portion of the new section is confusing and unnecessary.
6. New Section 3, Sub (2) allows for a one-time exemption for transfers from husband to wife, or parent to child, but the property cannot be transferred again for 3 years after the initial transfer. Tracking such transfers and keeping a log would create work for either the county treasurer’s office, or DOR. The bill does not specify who would be responsible for such a log, or who would enforce the 3 year provision
7. New Section 5, Sub (2)(a) refers the appeal provision to 15-1-211, MCA, which is the Office of Dispute Resolution. According to that statute, property taxes are specifically excluded from that process. The appeal should be directed to the county tax appeal process outlined in 15-15-101 through 104, MCA.
8. New Section 5 provides for a penalty for falsifying the value recorded on the realty transfer certificate. Clarification in the bill is needed to specify whether the county treasurer, or DOR would be responsible for applying the penalty.
9. Information collected on the realty transfer certificate is confidential under 15-7-308, MCA. A 1% tax on the value of property on the certificate, if made public information, would provide confidential information from the realty transfer certificate. SB474 could include a provision that specifies that the 1% tax on each transfer of property is confidential information.
10. New Section 7 (1) allows for an income tax credit on the first $425,000 of taxable market value. There is no definition of “taxable market value” in the bill. The fiscal note assumes this to mean the first $425,000 in value that is taxable under the proposals realty transfer tax, or the value between $75,000 and $500,000. However, the definition of taxable market value under property taxation is the value after the homestead (31%) or commstead (13%) exemption has been applied. The proposal should include language that specifies what is meant by ‘taxable market value”.